



*- Federal Mid-Level Supervisors*

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PROFESSIONAL MANAGERS ASSOCIATION

TESTIMONY  
ON  
DEVELOPMENT OF A SUPPLEMENTAL  
CIVIL SERVICE RETIREMENT PLAN  
BEFORE  
COMMITTEE ON POST OFFICE AND CIVIL SERVICE  
CHAIRMAN  
WILLIAM D. FORD

BY  
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Thank you for the opportunity to testify. My name is Michael J. Riselli and I am the General Counsel of the Professional Managers Association, a non-profit membership association which represents federal mid-level managers.

In our testimony today we want to give you PMA's general position on the pension plan for new Federal employees and to suggest some areas the Committee may wish to look into.

First, it is PMA's position that the benefits from the pension plan adopted for new Federal employees plus the Social Security benefits attributable to their years of Federal service should equal the benefits provided solely by the Federal Civil Service Retirement System to pre-1984 Federal employees. And, second, it is our position that the pension plan should be a defined benefit pension plan, as is the present Civil Service Retirement System.

There are several important reasons for our recommendations.

First, we would like to emphasize that employee benefits, and especially pension benefits, are not a gratuity. From the employer's point of view, a good pension plan is simply good business. The employer's goal is to attract and retain the best employees and to encourage and sustain productivity through good employee relations. The Federal Government, as employer, may be expected to have additional public policy goals and the goal of setting an example as well as goals of fairness. Today employees expect to maintain the standard of living attained during their working years into their retirement years. It is generally accepted that this goal can be accomplished for the bulk of the population only through Social Security plus employer-sponsored pension plans. The more progressive companies provide pension benefits which, together with Social Security, accomplish this goal.

At this point I would like to point out that there are several misconceptions

surrounding the present Civil Service Retirement System. One of these misconceptions is that it is overly generous. The Civil Service Retirement System provides adequate, not opulent, benefits. It is generally agreed that 50 to 75 percent of the current value of the employee's gross compensation at retirement is needed to enjoy a post-retirement standard of living reasonably comparable to the pre-retirement standard of living. An employee who retires from the Civil Service Retirement System with 30 years of service and unreduced benefits will receive 56.25 percent of the three highest years' average salary. The maximum pension benefit that can be earned by a civil service employee is 80 percent of the average of the three highest years of salary and that requires 41 years and 10 months of service. On the other hand, it is apparently not uncommon for employees in the private sector to receive much higher benefits. The Employee Retirement Income Security Act, as amended, prohibits private-sector defined benefit qualified pension plans from providing benefits higher than the lesser of (1) \$90,000, adjusted for inflation, or (2) 100 percent of the participant's average compensation for the highest three consecutive years. These limits are based on benefits attributable only to employer contributions. Benefits higher than these limits can be provided outside the qualified plan through excess benefit pension plans and other types of non-qualified pension plans. The Civil Service Retirement System is comparable to or, in some cases, inferior to the combination of benefits provided through the pension plans of the more progressive companies in the private sector and Social Security. And when you consider additional benefits provided by many private-sector companies, such as stock, profit-sharing, savings and thrift plans, excess benefit plans, etc., there is an even greater disparity. And, let's not forget, these benefits are based on larger salaries -- witness the large

number of political appointees, many young and in the early years of their careers, who leave the Federal Service after brief appointments because they claim they cannot live on such low pay any longer.

In your deliberations we suggest you look at the benefits provided the employees of the more progressive companies which have workforces comparable to the Federal Civil Service, consisting in such large part of professional and technical employees who are experts in many diverse fields, managers, attorneys, actuaries, scientists, employee benefit plan specialists, accountants, veterinarians, doctors, program analysts, etc. It is largely these progressive companies with which the Federal Government competes for employees.

And, at this point, PMA would like to point out, these private-sector plans are almost always financed with no contributions required from employees (although employees do, of course, contribute to Social Security).

Studies have indicated that the trend in employee benefits in the private sector has been in increasing and improving benefits. There have been some short periods when this trend has slowed because of various economic situations, but, overall, the pattern has been to increase and improve benefits. Thus, with the passage of years, more and more pension plans have improved their benefit formulas to provide benefits based on final earnings; more plans have lower retirement age for unreduced benefits; more plans subsidize earlier retirement; more plans provide for short vesting periods; more plans provide post-retirement benefit increases because of inflation. And so on.

There are sound reasons for all of these improvements -- equity considerations and business and financial considerations among them.

PMA considers it unwise to consider downgrading the benefits to be provided new Federal employees. Accordingly, we recommend that the benefits from the pension plan adopted for new Federal employees plus the Social Security benefits attributable to their years of Federal service should equal the

benefits provided solely by the Civil Service Pension Plan.

Federal employees.

Why does PMA recommend a defined benefit pension plan? (I want to emphasize here that while PMA recommends the defined benefit pension plan, it has no objection to ADDITIONAL benefits being provided through a defined contribution approach.) A little background may be in order at this point. As you are no doubt aware, there are basically two types of pension plan. Defined contribution plans promise only a specified contribution from the employer for each employee. The ultimate retirement benefit depends upon how much is in the employee's account at the time of retirement and will not be known until retirement. Defined benefit pension plans provide a specified benefit at retirement -- and sufficient contributions must be made to ultimately provide that benefit. So, in defined benefit pension plans, the benefit is known. In defined contribution pension plans only the amount of the contribution is known. In defined benefit pension plans, the risk of providing the benefit is borne by the employer. The employer must contribute, and the investment of these contributions must generate, a sufficient amount to provide the promised benefit. At this point, I would like to quote a remark made by Professor Dan M. McGill before the Policy Forum of the Senate Governmental Affairs Committee, December 13, 1983. He said, in speaking of private-sector defined benefit pension plans, "It is relevant to note that if a fully funded plan consistently earns a 6 percent rate of return, approximately 70 percent of plan costs will be met out of investment earnings. Stated differently, 70 percent of the benefits will be paid out of investment income rather than plan contributions." Moreover, it should not be overlooked, as the President of Martin E. Segal Company pointed out at the same forum, that, for a given contribution, a defined benefit plan can generally provide more in the way of benefits than can a defined contribution plan. In defined contribution plans,

the risk is borne by the employee. The amount of the employee's account at retirement will determine the benefits to be provided and cannot be known in advance. The size of the account is affected by the amount contributed, the investment gains and losses, and the value of distributed plan forfeitures, as well as market conditions prevailing at retirement, i.e., interest and annuity rates in effect at the time of retirement.

Most large employers provide defined benefit pension plans. Some also provide defined contribution plans in addition. The vast majority of employees in both the private sector and the public sector are covered by defined benefit pension plans.

There are some advantages and disadvantages, from both the employer's and the employee's points of view, of each type of plan. Defined contribution plans work to the advantage of young, short-service employees. Employers utilize defined contribution plans for the following reasons: as a supplement to an existing defined benefit pension plan; as a first step in providing pension benefits; to benefit young, short-service workers; or to avoid long-term liabilities. For employees who eventually make a job commitment, even late in their careers, the defined benefit pension plan is generally the most favorable because it provides a known result with minimum risk and can be designed to provide fully adequate benefits even for employees who are hired relatively late in life and who will have only 20-25 years of service under the plan. Moreover, although there has been a recent increase in defined contribution plans for various reasons (the regulatory environment, etc.), many experts have expressed concerns about relying on defined contribution plans to provide all or part of the basic pension benefits and have indicated that these concerns have not been adequately explored as yet. For these reasons, PMA favors a defined benefit pension plan for new Federal employees.

PMA would also like to take this opportunity to point out a few areas that the Committee may wish to explore.

First, in the private sector, a qualified pension plan is basically a separate entity from the employer which sponsors the plan. The employer does not own plan funds and may not use plan funds for its own purposes; plan funds must be prudently invested and must be for the exclusive benefit of plan participants and their beneficiaries; investments must be diversified; and plans are required to comply with strict funding rules. On the other hand, the Civil Service Retirement System trust fund is merely an account within the Federal Treasury. By law the trust fund must be invested only in interest-bearing Government securities and, as we all know, Government securities over the long term have provided relatively low rates of interest. Another result of this requirement is that the Civil Service Retirement System trust fund has been available for other Federal expenditures. If the Civil Service Retirement System were designed more along the lines of private-sector retirement plans, the costs to the Government of providing retirement benefits for its employees would be much smaller. There are reasons for requiring private-sector pension plans to be set up in the manner they are which are not applicable to a plan for employees of the Federal Government. However, if the chief concern is costs of the retirement benefits, the Committee may wish to examine whether it is possible that that problem can be solved by designing the system somewhat differently while at the same time continuing to provide adequate retirement benefits.

Another issue that is being discussed is the "ownership" issue, with the idea being proposed that safeguarding Federal employees' rights to pension benefits can be accomplished only through a defined contribution plan. If the goal is to strengthen Federal employees' rights to pension benefits, we submit that that goal can be accomplished under either type of

plan and does not require the institution of a defined contribution plan. The Employee Retirement Income Security Act of 1974, which regulates private-sector pension plans, prohibits private-sector pension plans from reducing accrued pension benefits. Surely, Congress is willing to comply with the spirit of such a provision it imposes on private-sector pension plans in order to provide Federal employees with the same simple safeguard it demands for private-sector employees.

Before concluding, PMA wishes to caution the Committee that in the discussions of pension benefits for Federal employees, there are myths and misconceptions being stated and accepted as facts, and comparisons being made between apples and oranges, sometimes inadvertently and sometimes probably deliberately. The pension field is a very complex one and we must be careful and precise in order not to come to erroneous conclusions.